

CREDIT OPINION

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State of Montana

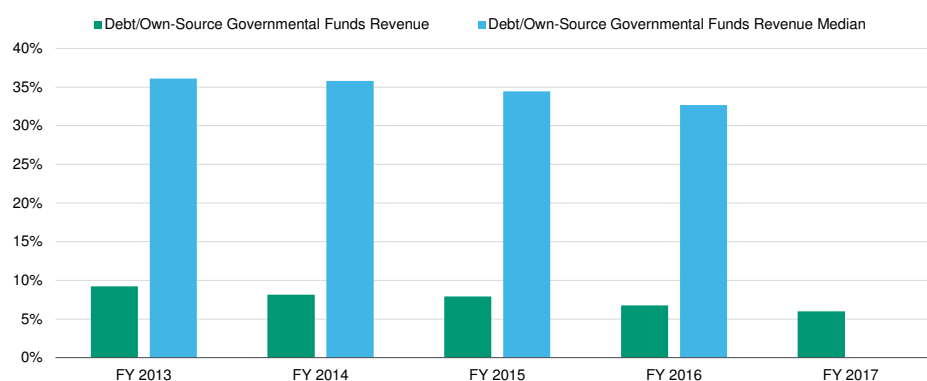
Update to credit analysis

Summary

The credit profile of the [State of Montana](#) (Aa1 stable) is characterized by low debt levels, a moderate pension burden, proactive fiscal management, strong liquidity levels, and an economy that continues to diversify, though it is still concentrated in the natural resources and government sectors. For the last two years, the state has been challenged by underperforming revenues, leading to expenditure reductions and draws on available fund balance.

Exhibit 1

Montana's declining debt levels remain well below the 50-state median



Sources: State CAFRs, Moody's Investors Service

Credit strengths

- » Low debt burden
- » Healthy liquidity
- » History of implementing expenditure reductions when needed to address revenue shortfalls

Credit challenges

- » Recently underperforming revenues leading to draws on available fund balance
- » Above-average dependence on the natural resources and government sectors
- » Personal income levels that remain low compared to national levels

Rating outlook

The stable outlook reflects the state's proactive fiscal management and continued maintenance of strong liquidity levels. Although available fund balance declined for the past two years, state officials expect to rebuild the general fund balance by the end of fiscal 2019 to levels consistent with the state's targeted reserve balance of 6% of general fund appropriations.

Factors that could lead to an upgrade

- » Sustained job growth with continued long-term economic diversification
- » Adherence to formalized financial best practices

Factors that could lead to a downgrade

- » Deterioration of the state's financial and economic performance leading to strained finances
- » Significant increase in debt and pension burden

Key indicators

Exhibit 2

Montana	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Operating Fund Revenues (000s)	2,966,775	2,990,643	3,146,491	3,020,427	3,099,135
Balances as % of Operating Fund Revenues	18.1%	11.5%	12.1%	4.2%	1.5%
Net Tax-Supported Debt (000s)	280,666	259,835	255,340	216,082	186,305
Net Tax-Supported Debt/Personal Income	0.7%	0.7%	0.6%	0.5%	0.4%
Net Tax-Supported Debt/Personal Income 50 State Median	2.6%	2.5%	2.5%	2.5%	N/A
Debt/Own-Source Governmental Funds Revenue	9.2%	8.1%	7.9%	6.8%	6.0%
Debt/Own-Source Governmental Funds Revenue Median	36.1%	35.8%	34.4%	32.7%	N/A
ANPL/Own-Source Govt Funds Revenue	128.2%	148.5%	147.4%	152.5%	N/A
ANPL/Own-Source Govt Funds Revenue Median	87.6%	81.8%	83.0%	82.2%	N/A
Total Non-Farm Employment Change (CY)	1.7%	0.8%	2.4%	0.7%	1.5%
Per Capita Income as a % of US (CY)	88.8%	87.6%	87.7%	87.2%	N/A

Sources: State CAFRs, US Bureau of Labor Statistics, US Bureau of Economic Analysis, Moody's Investors Service

Profile

Montana is the 44th-largest state by population (1.05 million people in 2017) and the 48th-largest state by gross domestic product (\$46.2 billion in 2016 current dollars). The state's wealth levels are below average, with per capita personal income equal to 87.2% of the US level in 2016.

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Detailed credit considerations

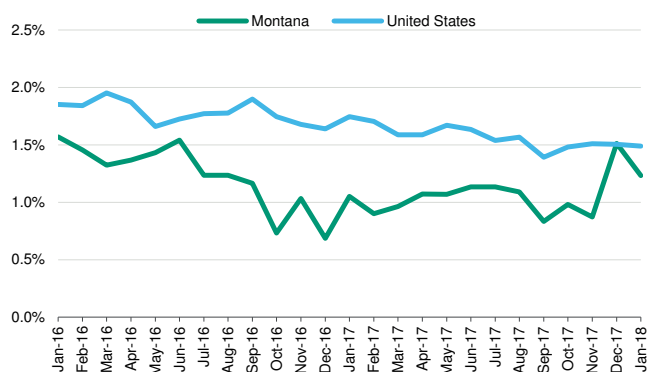
Economy: above-average dependence on natural resources and government sectors

Montana's economy will continue to diversify away from the natural resources and government sectors; however, these areas still make up a larger percentage of total non-farm employment in the state compared to the nation. In 2016, employment in the natural resources and mining sector accounted for 2.6% of total non-farm employment in the state, compared to 0.4% nationally. Government employment accounted for 18.4% of total state non-farm employment, compared to 15.3% in the US.

The state's job growth lagged the nation's pace for the past two years, though growth ticked up at the end of 2017 (see Exhibit 3). The healthcare and leisure and hospitality sectors are driving expansion in the state. Montana's per capita personal income levels remain low relative to the nation, although personal income growth has remained generally on pace with the nation's rate and exceeded national growth rates since the fourth quarter of 2016 (see Exhibit 4).

Exhibit 3

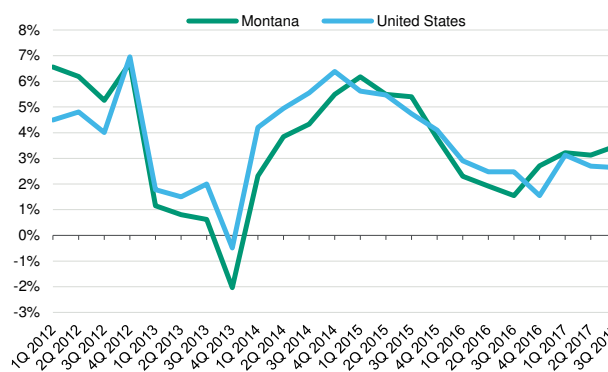
Montana's job growth has lagged the nation's pace Year-over-year monthly job growth



Source: US Bureau of Labor Statistics

Exhibit 4

Montana's personal income growth exceeded national rates in 2017 Year-over-year quarterly personal income growth



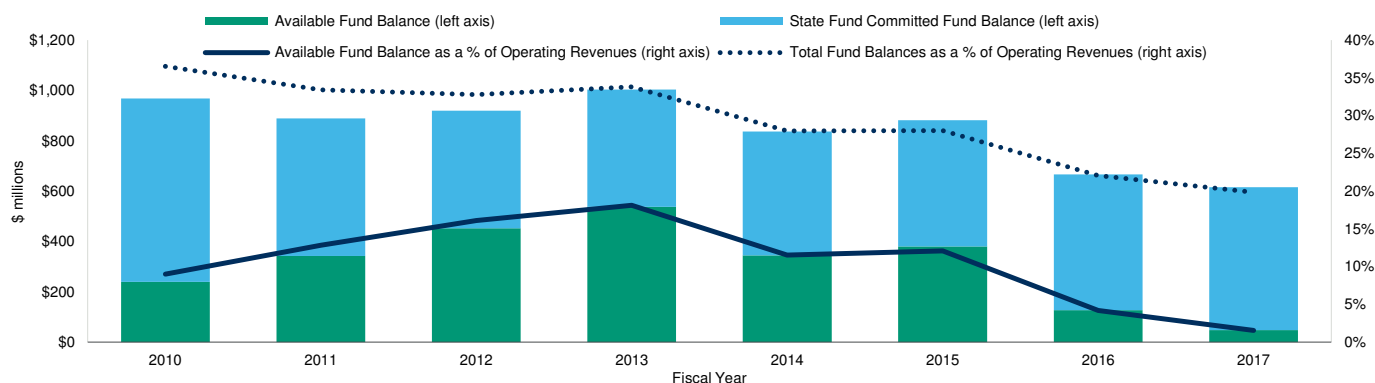
Source: US Bureau of Economic Analysis

Finances and liquidity: healthy liquidity position mitigates recently underperforming revenues

Montana's financial position will improve in the next year following two years of imbalanced operations. In fiscal 2016, general fund revenues declined by 3.9% while expenditures increased by 5.6%. This led to a decline in available fund balance (equal to the general fund unassigned fund balance) to \$126.5 million (4.2% of operating revenues) at the end of fiscal 2016 compared to \$380.4 million (12.1% of operating revenues) at the end of the prior fiscal year. Revenue softness occurred mainly in the areas of natural resource taxes, including the coal severance tax and the oil and natural gas production tax, and corporate income taxes. While the oil sector is smaller in Montana than in many other energy states, the decline of oil prices in 2015 and 2016 led to a decline of natural resource revenues, which offset growth in other revenue streams.

In fiscal 2017, total general fund revenues grew by 1.3% while expenditures grew by 4.0%, leading to another draw on available fund balance. The available fund balance at the end of fiscal 2017 was \$47.9 million (1.5% of operating revenues), which is its lowest level in the past ten years. Although the general fund unassigned fund balance remains low, the state maintains healthy fund balances in other funds. The committed fund balances in the state special revenue fund are committed by state statute for certain purposes, but the funds can be used for cash-flow needs and could be redirected with a simple majority vote of the state legislature in the case of an emergency. While these funds are rarely transferred due to statutory requirements, they provide some cushion if the state faces extraordinary financial pressures. At the end of fiscal 2017, the combined total of available fund balance and the state fund committed fund balance was \$615 million, or 19.8% of operating revenues (see Exhibit 5).

Exhibit 5

Montana's fund balances declined due to revenue softness in the past two years

Available fund balance is equal to the general fund unassigned fund balance.

Total fund balances are equal to the available fund balance plus the state fund committed fund balance.

Sources: State CAFRs, Moody's Investors Service

The state legislature used some state special revenue funds to help fill a budget gap estimated for the 2019 biennium last fall. In November, the governor called a special session of the legislature to address an estimated \$228 million budget deficit for the 2019 biennium. The deficit resulted from slower than expected revenue growth and an expensive fire season. The governor enacted \$76.7 million of expenditure cuts in response to the budget shortfall. In addition, the legislature approved revenue generating proposals totaling \$44.7 million and fund transfers totaling \$95.2 million, approximately \$30 million of which came from the state special revenue fund. State officials estimate the available fund balance to grow to approximately \$65 million by the end of fiscal 2018 and to \$145 million by the end of the 2019 biennium, which would be around the state's target of 6% of general fund appropriations. Year-to-date, state officials report strong revenue growth compared to the last two years.

LIQUIDITY

The state's overall liquidity level is healthy, mitigating the challenges faced by revenue shortfalls. The balance in the state treasurer's fund, the state's primary operating cash account, was \$813 million at the end of fiscal 2017. The treasurer's fund daily balance has remained in excess of \$150 million since 1986. The state also maintains sizable balances in a number of trust funds, including the permanent coal trust. Montana has not issued tax and revenue anticipation notes (TRANs) since 2003.

Debt and pensions: low debt levels and moderate pension burden**DEBT STRUCTURE**

Montana will continue to have one of the lowest debt burdens of all 50 states. According to Moody's most recent [state debt medians report](#), Montana had the fourth-lowest net tax-supported debt (NTSD) per capita (\$207) and NTSD as a percent of personal income (0.5%) in 2016. By comparison, the 50-state median for NTSD per capita is \$1,006 and for NTSD as a percent of personal income is 2.5%. Montana's NTSD includes general obligation bonds, coal severance tax bonds, and transportation grant anticipation notes.

DEBT-RELATED DERIVATIVES

The state is not a party to any debt-related derivatives.

PENSIONS AND OPEB

The state's retirement systems are administered by the Montana Public Employee Retirement Administration and the Teachers' Retirement Division. The state's pension liabilities are above-average for US states. Moody's adjusted net pension liability (ANPL) for Montana in fiscal 2016 was \$4.9 billion or 153% of state own-source governmental revenues. This figure is higher than the 50-state median of 82%, according to Moody's most recent [state pension medians report](#). Although Montana's pension burden is high, the state's very low debt burden results in a moderate overall debt and pension liability.

Montana's other post-employment benefits (OPEB) liability is minimal. The state offers health coverage to retirees at the same rate as current state employees. There is no direct state contribution on the retirees' behalf. The most recent estimate of the liability for the implied subsidy is \$301 million.

The state's overall fixed costs, including debt service, OPEB, and pension contributions, are manageable. In fiscal 2016, total fixed costs were equal to 7.7% of own-source governmental revenues, which is below the 50-state median of 8.8%.

Governance: willingness to correct mid-biennium budget imbalances

While the state lacks certain institutionalized financial best practices, such as the use of binding consensus revenue forecasting and formal multi-year financial planning of revenues and expenditures, it has established mid-course spending adjustments and contingency plans that enable management to take prompt corrective action to address budget shortfalls, as it did last November.

The state's mid-biennium correction process is a credit strength. The governor has the authority to reduce agency spending by 10% in the event of a general fund budget deficit (defined as a projected ending general fund balance for the biennium that is less than 5% of the general fund appropriations for the second fiscal year of the biennium prior to October of the year preceding a legislative session) so that the projected ending general fund balance for the biennium will be at least 6% of general fund appropriations for the second year of the biennium. Protected from reductions are debt service, the legislative and judicial branches, salaries of elected officials and public schools.

The legislature and executive branch have demonstrated a willingness to act promptly to correct mid-year imbalances. For Montana, this is particularly important as the economy, and consequently government revenue streams, remain dependent on potentially volatile natural resource prices.

In 2017, the state established a formal budget stabilization reserve fund, which would be funded with 50% of actual general fund revenues that exceed the legislature's revenue estimates by \$15 million. Currently, no funds have been transferred to the reserve fund.

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